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3121—37

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 106

MINNESOTA TEA COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13–19) is reported in 34 B. T. A. 145. The opinion of the Circuit Court of Appeals, filed April 7, 1937 (R. 36–41), is not yet reported.

JURISDICTION

The decree of the Circuit Court of Appeals was entered April 8, 1937 (R. 42). The petition for a writ of certiorari was filed June 2, 1937. The jurisdiction of this Court is invoked under Section 240

(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether cash received in a statutory reorganization by petitioner, and turned over to its stockholders in consideration of their assumption and payment of petitioner's debts, must be regarded as "distributed" in pursuance of the plan of reorganization, within the meaning of Section 112 (d) (1) of the Revenue Act of 1928, thus relieving from taxation to petitioner the gain included therein.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 11–12.

STATEMENT

Upon its first consideration of the stipulated facts of this case the Board of Tax Appeals held, in *Minnesota Tea Co.* v. *Commissioner*, 28 B. T. A. 591, that there was no statutory reorganization, and that therefore a consideration of the taxpayer's contest of the Commissioner's original determination of deficiency was precluded. This original determination was based upon the issue presently involved. Upon appeal by the taxpayer, petitioner herein, the Circuit Court of Appeals for the Eighth Circuit held, in *Minnesota Tea Co.* v. *Commissioner*, 76 F. (2d) 797, that a statutory reorganization had been effected within the meaning

of Section 112 (i) (1) (A) of the Revenue Act of 1928, reversed the decision of the Board, and remanded the case for consideration of the original issue. The decision of the Circuit Court of Appeals was affirmed by this Court in *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378. (R. 13–14.)

The Commissioner determined that cash received by petitioner in a statutory reorganization in the sum of $426,842.52, and immediately distributed to its stockholders, was, to the extent of $106,471.73, a distribution for the benefit of creditors, since the stockholders were required to pay corporate debts in that amount; and therefore that the cash was, to that extent, not distributed in pursuance of the plan of reorganization within the meaning of Section 112 (d) (1), Revenue Act of 1928. The Commissioner accordingly included the sum of $106,471.73 as profit on disposition of assets and computed the tax on that basis. (R. 10–12.)

The stipulated facts show that petitioner formed or caused to be formed on July 14, 1928, the Peterson Investment Company and transferred to it certain assets in exchange for the entire capital stock of the latter (R. 8, 36). Subsequently, on August 23, 1928, petitioner transferred all its remaining assets to Grand Union Company for 18,000 shares of Grand Union Company stock and $426,842.52 in cash (R. 8, 14). In the transfer to or exchange with Grand Union Company, petitioner was committed, by a resolution adopted the previous day,

immediately to turn over to its stockholders, who were three in number, the cash it received in the exchange. The resolution is as follows (R. 8–9, 14, 31):

> Resolved further that all moneys received by Minnesota Tea Company on such sale of its assets and in consideration thereof, whenever received, shall be immediately distributed to the stockholders of Minnesota Tea Company ratably and in the proportion of their respective stockholdings in Minnesota Tea Company upon the assumption by the stockholders of all the corporate debts of Minnesota Tea Company in order to enable the company to hold all the corporate stock and securities received by it for its assets on such sale thereof without being compelled to sell any part of the same, and the Board of Directors are hereby authorized and directed to so distribute the said moneys as aforesaid and in behalf of the company enter into a written agreement with the stockholders, signed and executed by the company and all the stockholders whereby said stockholders, in consideration of such distribution and for the purpose of enabling the company to continue to hold the said corporate stock and securities without being compelled to sell any part thereof for the payment of existing debts, agree to pay all the corporate debts of Minnesota Tea Company whether due and payable or not and whether certain or contingent.

The money was turned over by petitioner to its three stockholders. Its corporate debts amounted to $106,471.73. The evidence does not contain the written agreement required by the resolution, but it is stipulated that the amount of the liabilities was assumed and discharged by the shareholders. (R. 14.) The stockholders themselves were creditors of petitioner in the aggregate sum of $6,524.10 and these debts were paid by means of the stockholders retaining out of the first cash received the respective amounts due them (R. 9).

The Board of Tax Appeals held that the provisions of the resolution with respect to distribution of cash by petitioner and the agreement by the stockholders to assume the debts were not conditioned upon each other, that there was an express distribution of all the cash among the shareholders within the literal language of the statute, that the dominating purpose of the reorganization provisions of the statute is illusive, and, upon these grounds, reversed the determination of the Commissioner (R. 15–18). In a dissent, six members of the Board expressed the opinion that the distribution was expressly conditioned upon the assumption of the corporate debts by the stockholders and that they took the distribution subject to this condition. The minority also felt that this transaction, for tax purposes, was not essentially different from a situation where the corporation had dis-

charged its debts directly with cash received in a reorganization (R. 18–19).

The Circuit Court of Appeals reversed the Board. Construing the resolution under which the cash received in the statutory reorganization was distributed to the stockholders, the court held that "the payment of this indebtedness by the stockholders was a condition attached to and governing the distribution;" futher, that petitioner "received the full benefit of this payment to the same extent as though it had retained that amount from distribution and applied it to payment of such indebtedness; * * *" (R. 40–41). Accordingly, it concluded that there was not a genuine distribution of the sum of $106,471.73, but rather a circuitous retention and application thereof by petitioner. The case was remanded to the Board for a determination of the gain in accordance with the opinion. (R. 41.)[1]

ARGUMENT

The narrow question presented in this case is whether a portion of the cash received by petitioner in an exchange constituting a statutory reorganization is exempt from taxation in its hands when distributed to its stockholders upon the condition

[1] The basis of the assets transferred by petitioner to the Grand Union Company was $199,016.09 (R. 12). It appears, therefore, that since petitioner recovered more than this sum in the cash payment received of $426,842.52, the entire amount of $106,471.73, the total of corporate debts paid, is includable in petitioner's gross income for the taxable year.

that the latter assume and pay all the corporate debts of petitioner.

The corporate debts so discharged under the method arranged amounted to $106,471.73. The court below held that to the extent of the debts paid the distribution to the stockholders by petitioner was not a genuine distribution but a circuitous retention and application of a part of the distribution for the payment of corporate debts (R. 41). In other words, the court held that petitioner merely used its stockholders as a conduit for payment of its debts, and gain realized and used for this purpose cannot escape taxation under the reorganization provisions of the statute.

Section 112 (d) (1) and (2) of the Revenue Act of 1928, *infra,* provides that if the corporation receiving money in a statutory reorganization "distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but * * * If the corporation receiving such * * * money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, * * *."

Under these provisions the entire amount of cash received by petitioner (less the cost basis of the transferred assets), if not distributed to its stockholders in pursuance of the plan of reorganization, would have constituted a realization of the gain upon the exchange to that amount and would have

been taxed accordingly; and furthermore, if the entire amount had been distributed absolutely to the stockholders, they, and not petitioner, would have been subject to taxation upon the gain realized.

But in the instant case, as pointed out by the court below (R. 40–41), petitioner, by its conditional distribution, accomplished the payment of its debts just as if it had actually retained that amount from the distribution and applied it to the payment of the indebtedness. Under either plan—i. e., either the method adopted in this case or the actual retention of the sum and its application to the indebtedness by petitioner, followed by the distribution of the balance to the stockholders—the result would have been the same both as to petitioner and its stockholders, for in either case not only would the indebtedness have been satisfied, but there would have been distributed to the stockholders for their own use the same amount in the end. Here the corporation was not a conduit for the stockholders, but the stockholders were a conduit for the corporation. Certainly, in the circumstances, the Circuit Court of Appeals was justified in deciding that there was not the kind of distribution contemplated by the statutory provision granting an exemption to a distributing corporation. What was actually a payment of corporate indebtedness may not be translated into a tax-free distribution to stockholders merely be-

cause the payment of the indebtednes was made or routed through the stockholders. Cf. *Gregory* v. *Helvering,* 293 U. S. 465, 469.

While the precise question decided below and presented by the petition has not been passed upon by another Circuit Court of Appeals, in principle the decision below is in harmony with *West Texas Refining & D. Co.* v. *Commissioner,* 68 F. (2d) 77, 80 (C. C. A. 10th), and *Liquidating Co.* v. *Commissioner,* 33 B. T. A. 1173, which hold that the "distribution" referred to by the statute is a distribution to stockholders and not to creditors of the corporation.

None of the cases cited by petitioner (Pet. 7, 9) considered or decided the question whether cash received by a corporation in a statutory reorganization was distributed in accordance with Section 112 (d), Revenue Act of 1928, *infra,* or corresponding provisions of the other revenue Acts. *Hendler* v. *United States,* 17 F. Supp. 558, decided by the United States District Court for the District of Maryland on December 30, 1936, involved the question of whether the assumption and payment of liabilities of a transferor corporation by the transferee corporation, both being parties to a statutory reorganization, constituted the receipt by the transferor of "other property or money" under the reorganization provisions. That case is now pending on appeal in the Circuit Court of Appeals for the Fourth Circuit.

CONCLUSION

The decision below is correct. The question involved is not of general importance and there exists no conflict among the Circuit Courts of Appeals. The petition should therefore be denied.

Respectfully submitted.

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JULY 1937.

APPENDIX

STATUTES INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

* * * * *

(c) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

(d) *Recognition of gain or loss.*—In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 112.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * *

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of

subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

* * * * *

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